

VZCZCXYZ0007  
RR RUEHWEB

DE RUEHSI #0901/01 1511133  
ZNR UUUUU ZZH  
R 301133Z MAY 08  
FM AMEMBASSY TBILISI  
TO RUEHC/SECSTATE WASHDC 9519  
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE  
RUCPDO/DEPT OF COMMERCE WASHINGTON DC

UNCLAS TBILISI 000901

SENSITIVE  
SIPDIS

STATE FOR EUR/CARC AND EEB/CBA  
COMMERCE FOR DANICA STARKS

E.O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [PGOV](#) [GG](#)

SUBJECT: PM GURGENIDZE: GEORGIA BUILDING "IDIOT-PROOF"  
ECONOMIC SYSTEM TO SUSTAIN GROWTH AND ATTRACT NEW INVESTMENT

11. (U) Summary: Prime Minister Lado Gurgenedze told the American Chamber of Commerce on April 30 that Georgia is living proof that "supply side economics works". His speech to the group was essentially the same as he presents to potential investors at the "Invest in Georgia" conferences the government has organized in various American and European cities. Gurgenedze was educated in the United States, lived in Florida for some years, and on his return to Georgia headed the country's largest commercial bank. He paints an attractive -- and not too exaggerated -- picture of a government with a clear vision of how it wants to revitalize Georgia with extremely open and liberal policies that are beginning to produce results. Gurgenedze said the GOG wants to "idiot proof" its economic system to make it safe from "tax and spend" policies under future governments. With most reform now in place, he said, the next step is to create an offshore financial system that will attract USD 10-15 billion to Georgia in the next five years. Such a system will feature limited prudential oversight but strong anti-money laundering controls. Gurgenedze admitted the government needs to do better to increase "buy-in" from the poor population in Georgia for the government's libertarian policies. He estimates that 20 billion dollars of new investment is needed to reduce unemployment to manageable levels. Gurgenedze did not address the very real need for greater confidence in the rule of law and the judiciary in Georgia as a spur to further economic growth. End Summary.

12. (U) Gurgenedze vowed that the GOG will continue to cut taxes and regulations, and proudly pointed to a 500% increase in tax revenues over the past five years as tax rates have declined. The result has been a "Shumpeterian" burst of entrepreneurship, he said. Fifty thousand new businesses were registered in 2007, and there are now a total of 360,000 registered, one of the highest rates in the world, Gurgenedze said. He pledged to maintain the liberal legislation the Saakashvili government has put into place up to now. In particular, he defended what are often deemed to be exceedingly employer-friendly labor laws. In a private conversation with AmCham leaders after his speech, he insisted the labor code will only be changed "over my dead body".

13. (U) What Georgia is seeing now, Gurgenedze said, is an emerging middle class, more cars, telephones, bank accounts and better infrastructure. He admitted that exports are something of a disappointment and too low at 31 percent of GDP. The current account deficit makes the economy vulnerable, he said, but not more so than many other countries. The silver lining is that unlike Venezuela and some other countries rich with natural resources and strong current account surpluses, the GOG cannot afford to make political mistakes. Reducing the current account deficit by

increasing exports is a government priority, he said, but not by means of subsidies. The appreciating trend of the national currency does not concern Gurgenedze, except as against the euro, and for the moment that relationship is fairly stable. The lari's appreciation against the dollar only makes energy cheaper and does not affect the country's export potential. (Note: Gurgenedze did not mention that most Georgians' savings are still dollar-denominated and they are quite uncomfortable with the dollar's decline against the lari.)

¶4. (U) Gurgenedze noted that remittances are 4 percent of GDP, which he said is an important source of national income but not one on which the economy is over-reliant. As an example of over-reliance, Gurgenedze cited Tajikistan, where remittances approach 25 percent of GDP. Foreign investment continues to accelerate, Gurgenedze said, with first quarter 2008 being the country's best quarter for such inflows in its history. He expects the positive trend to continue over the next five years, despite the Russian embargo and worldwide financial problems. Already Georgia is one of the freest economies in the world, Gurgenedze said proudly, and the benefits are beginning to be felt. GDP per capita has increased to USD 2315. Gurgenedze expects that Georgia will be able to close the gap in GDP per capita on a purchasing power parity basis with countries such as Romania and Russia within three years, putting Georgia on a par with the poorest members of the European Union. Recent growth has been broad-based according to Gurgenedze, with all sectors of the economy contributing -- "Georgia is not a monoculture". There is strong variance in the sources of foreign investment, and in particular, no other country of comparable size has such a strong popularity among institutional

investors. Total capital inflows in 2007 were USD 2.3 billion. Those investors who recently bought Georgia's -- oversubscribed -- eurobond know and are quite comfortable with Georgia's credit risk, Gurgenedze said. Closer to home, Gurgenedze said Georgia will welcome Azeri and Armenian entrepreneurs to set up businesses in minority areas such as Akhaltsikhe and Marneuli in order to take advantage of the liberal environment.

¶5. (U) Gurgenedze said Georgia has largely done all that is needed in economic reform. He said the GOG is designing its economic system to be "idiot-proof" and safe from encroachment by possible future "social democratic" governments. The government's idea is to build inertia in economic thinking into the legislative framework, making it hard to return to "tax and spend". He referred to recent legislation mandating a small annual budget surplus and explicit inflation targets for the central bank. Under the latter law, the central bank's inflation target must be 10 percent or less and the central bank president loses his job if that limit is exceeded for more than a year. Gurgenedze said the government has reduced its debt load to 23 percent of GDP from 56 percent, and external debt is only 15 percent of GDP. Debt service is only 5 percent of revenues, he said, and this modest level of indebtedness promotes resilience to external shocks. Budget revenues have increased from 16 percent to 29.7 percent of GDP. Expenditures are too high at 30 percent of GDP, he said. Gurgenedze would like them to be 20 percent of GDP, but will settle for 23-24 percent. Inflation is more than Gurgenedze likes, and he said it will go higher before it comes down. Still, he said, it is less than that in Ukraine, Kazakhstan or Russia. The central bank has increased interest rates by 500 basis points since early 2007, and is ready to increase them more if required, he added.

¶6. (U) Gurgenedze, said the domestic banking sector is "plenty competitive" but also healthy. He is satisfied with the commercial banks' ratio of loans to deposits of 1.3, but would not want to see it any higher. He said he was sure the bankers are aware of that. Not surprisingly for a former banker, Gurgenedze is an advocate for regulation of the banking sector "with a light touch". He opposes "rules-based" regulation, which he contends would cost the

country a couple of percent of GDP growth.

17. (U) Now, Gurgenedze said, the government wants to create an attractive offshore financial system for foreign investors. He wants Georgia to be a clean but low tax jurisdiction. The government's experts have to draft more than 60 new laws to put the project in place, but Gurgenedze expects the task to be completed by the end of the year. Under the new laws, "international financial companies" will be easy to set up, but will be permitted to hold only 10 percent in Georgia-sourced capital. They will be completely free not only of Georgian taxes, but also Georgian prudential supervision. The system is to be designed for sophisticated investors, and the rule will be "caveat emptor". However, Gurgenedze said, as the GOG liberalizes it will tighten money laundering controls, because "once a jurisdiction gets the stigma it can't get rid of it." The new system will draw on the best of Gibraltar and Singapore, he said. Georgians speak Russian and English, and can learn Turkish and Arabic to serve clients, Gurgenedze said. Georgia will have the most liberal regime in the region, and with Lebanon gone, Dubai too expensive and Cyprus now under EU legislation, he expects Georgia will be successful in attracting as much as USD 10-15 billion in the next five years, employing 6000 people in new jobs, half of them expatriates. He does not find this goal unrealistic, especially since he intends to "market the hell out of it."

18. (U) At the end of his speech, Gurgenedze addressed the political implications of the government's liberal economic philosophy. The fact is, he said, the economic glass is three-quarters full and one-quarter empty. The government needs better communication to explain that. Talking about the ease of doing business is largely irrelevant to the country's poor population, he said. The government is libertarian, but doesn't want reform to be a "dirty word." It wants social cohesion and buy-in even from the very poor, who must understand the connection between investment and job creation. For five years, Gurgenedze said, the country has had jobless growth, with the total number of jobs stuck at 1.75 million as the public sector sheds jobs as fast as the private sector creates them. He contended that the quality of jobs and wages has increased, however, even ahead of

productivity growth. He said the country needs USD 20 billion in investment to reduce unemployment to manageable levels. In the meantime, Gurgenedze said, the government is doing what it can to increase social payments. However, the goal is means-tested payments instead of giving a little to everyone. There are close to one million poor people in the country, Gurgenedze said, and the government wastes assistance on people who don't need it. In the long term, he is convinced that growth will take care of the problem.

19. (SBU) Comment: Gurgenedze's vision of a very free and competitive economy, is well on its way to reality, certainly on paper. He revealed that his enthusiasm for libertarianism carries with it some insensitivity when he asked the AmCham audience how many of their parents "really needed" the small pension payments they receive. Although they understood his point about the need for means-testing, most of his listeners were taken aback as they imagined their parent's reaction to giving up the pensions they had earned. The National Movement's sweeping victory in the recent elections gives them the power to continue on the path Gurgenedze mapped out.

This points up the one real worry in many business owner's minds, which was voiced by a businessman to Econoff. He asked whether with an overwhelming victory, Saakashvili will take it as a mandate to "do whatever he wants and ignore process and property rights whenever it suits him". The question gets to the heart of the need for strengthening rule of law and particularly the court system -- issues which Gurgenedze understandably based on his logic did not address.

In the long run, more confidence in the judiciary will do as much as any of Gurgenedze's other plans to ensure that investment and economic growth reach their full potential.

End Comment.

TEFFT